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C O N F I D E N T I A L CARACAS 001943

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TAGS: ECON EFIN EPET PGOV VE
SUBJECT: PDVSA MONEY GOES STRAIGHT TO GOV SPENDING

REF: A. CARACAS 1443
¶B. CARACAS 1904

Classified By: AMBASSADOR CHARLES S. SHAPIRO FOR REASONS 1.5 (B) & (D)

¶1. (C) SUMMARY: Central Bank (BCV reserves) peaked on May 14, and have since been dropping sharply. The chairman of the National Assembly Finance Committee and the President of state-owned oil company PDVSA have publicly confirmed that the reason for the decline is that PDVSA has ceased turning over its income to the BCV for conversion into Bolivars, an act that critics call illegal and unconstitutional. The reason for this diversion appears to be to subsidize a new "Special Development Fund" announced recently by President Chavez, which is purportedly worth USD 2 billion. After asking the BCV for, and not receiving, his mere "millardito" (a billion USD - see reftel A), he apparently has found a way to simply take two, courtesy of high oil prices. END SUMMARY.

RESERVES DROPPING

¶2. (SBU) BCV reserves peaked at a total of 24.721 billion USD (including the Macroeconomic Stabilization Fund, or FEM, a separate account for GOV revenue, theoretically to be built up when oil prices are high, but which in fact has less now than since its second month of existence) on May 14, but have since fallen to only 23.869 billion as of June 4. NOTE: This is not due to BCV providing forex to pay for imports, as the amount of foreign exchange CADIVI (the Commission for Foreign Exchange Administration) approved in May was only USD 17 million more than in April. Even if forex approvals had increased substantially, it would not be enough to account for the drop, since reserves had been growing steadily since exchange controls were put in place in January 2003. For example, the reserves grew by just over 1 billion USD in April 2004, 2.9 billion since January 1, and 8.58 billion in the 12 months ending April 30. END NOTE.

PDVSA WITHHOLDING INCOME

¶3. (U) Newspaper articles on June 3 stated that PDVSA's finance team had received orders to suspend selling foreign currency to the BCV for at least the period of June through August of this year. Daily "El Nacional" quotes anonymous BCV reps as saying that at least $750 million was also diverted in the month of May. In the face of these stories, Rodrigo Cabezas, MVR party Deputy and head of the National Assembly Finance Commission, announced June 4 that this was indeed the case, and was the result of a decision made by the PDVSA board of directors. The reason Cabezas gave is that any reform to the FEM law would have been delayed until the second half of the year, so PDVSA "assumed responsibility" and found a "short-cut." PDVSA President Ali Rodriguez subsequently echoed Cabezas' comments on June 7 and assured that the move was perfectly legal, and in fact was done with the approval of the BCV.

¶4. (U) Numerous independent economists have questioned this action, on grounds of legality and transparency. The BCV law, for example, specifically states that foreign exchange obtained from oil exports "must be sold exclusively to the Central Bank." Also, the Constitution precludes any extra-budgetary spending. Salomon Centeno, another member of the Finance Committee (and deputy from opposition party Accion Democratica) stated that the Assembly did not approve such an act and called for a special commission to investigate it.

¶5. (C) The BCV seems to at least be aware of the reasons, although it is not clear that it approved the short circuiting of normal procedures, as PDVSA President Rodriguez asserted. Milton Guzman, an economist at private Banco de Venezuela and former BCV employee, told econoff that his former co-workers have told him of an internal BCV memo that had circulated, telling employees in the financial operations area that the PDVSA money would not be forthcoming. The

development fund may actually be the idea of BCV President Diego Castellanos, who suggested it in a February 2004 letter

to the Finance Committee during a period of public debate about the "excess reserves." However, this letter did not offer approval of the current method, since it stated that any fund must be "in conformity with currency exchange standards," which Cabezas indicated at the time would be the case. No one from the BCV has made any public statements about the issue since the reserves began dropping.

MONEY FOR SOMETHING

¶6. (U) The destination of these funds appears to be a new "Special Development Fund" announced by President Chavez on May 23. He stated that USD 2 billion in oil funds would be used to finance national development projects, and said that USD 200 million were already designated for a sugar mill (being built with assistance from Cuban experts), a new state airline, a subway line in a Caracas suburb, and an irrigation system in western Venezuela. Chavez claimed at the time that the money had been found in a "secret" PDVSA account that had been hidden by the BCV. Banking Superintendent Trino Alcides also stated that this account was indeed worth just over USD 2 billion.

ONLY THE BEGINNING? PERHAPS NOT

¶7. (C) There are strong indications that funds have been diverted in this manner for some time, though not in their entirety. Some weeks ago, Luis Zambrano, senior economist of Banco Mercantil, told econoff he had learned that PDVSA was using money from its "Rotating Fund" (fondo rotatorio) to fund domestic social programs. This fund, maintained in dollars, is legal, but was created for the express purpose of facilitating PDVSA's routine foreign purchases of equipment and other goods. Zambrano believes that this method was not utilized until 2004, and estimated that spending from it would reach USD 3.3 billion for 2004 if Chavez remained in power.

¶8. (C) Efrain Velazquez, President of the National Economic Council (CEN, a group of private economists and businessmen that was created nearly 50 years ago to advise the executive branch and is now all but ignored), told econoff in May that he was involved in discussions about a possible new law to affect BCV reserves (reftel A). The proposed text would allow PDVSA to keep between one and two billion USD a year, and designate the funds for "social projects." When Velazquez protested that this would be inflationary, the BCV reps at the meeting told him it should not be a concern because the money would be spent in dollars "for political activities abroad." Velazquez told econoff that he believes that such funds would likely be spent domestically, but suggested that is any of it were spent outside of Venezuela, it might go to Evo Morales in Bolivia or other ideological allies.

¶9. (C) Analysis of official GOV numbers raise questions as well. While the reserves have been rising since January 2003, BCV numbers indicate that the rate of increase has been slowing. They increased by about USD 710 million/month over the course of 2003 (and USD 950 million/month from August to December, when CADIVI forex liquidations were at levels comparable to those of 2004), but by only USD 633 million/month in 2004 through April. This 10.8% slowdown is despite an 11.6% increase in oil prices, from an average of USD 25.82 per barrel in 2003 to USD 28.82 in 2004 (through April - up to USD 34.40 for May).

COMMENT

¶10. (C) Considering that a BCV employee told econoff that the "secret" PDVSA account that Chavez planned to tap was never a secret (nor does it make sense for it to have had USD 2

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billion in it), we believe that Chavez' assertion was simply laying the groundwork for the PDVSA decision. Since the BCV has refused to turn over money that "rightfully" (according to Chavez) belongs in the hands of the GOV, they can argue

that robbing the BCV is only taking back what has been taken from them. Chavez, repeatedly thwarted by the BCV and their bothersome insistence on legality, is clearly unwilling to settle for less.

¶11. (C) We have our doubts as to how much of the money will be spent on big ticket infrastructure projects such as those Chavez named. Much, we expect, will go to financing thinly

disguised transfer payments to his key lower-income constituents through the various "missions." In any event, it does not appear that the money will be spent under the budget, which is debated publicly and subject (at least theoretically) to scrutiny by the National Assembly. How the USD 2 billion will be converted to Bolivars is another unknown. If it does not pass through the Central Bank, presumably it will be exchanged on the quasi-legal (though hardly transparent) parallel market.
SHAPIRO

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